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The Manufacturers Hanover
Financial Digest
Weekly Commentary, Selected Financial Data, and Business Indicators

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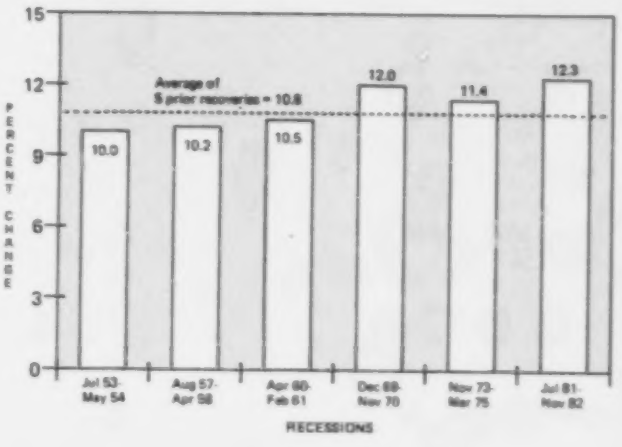
The Two-Year Old Expansion . . .

The same business forecasters who were hurriedly lowering their economic projections for 1985 just a few months ago are busy again. But this time they are doing just the opposite, namely, boosting this year's anticipated growth figures. This is because as January unfolds, a spate of upbeat business statistics covering the final months of 1984 has made it increasingly apparent that business activity is snapping out of last summer's doldrums. And if some observers of the economic scene had any lingering doubts about the economy's strength, last week's report on real GNP growth in the final quarter of 1984 should dispel them. According to the Commerce Department's estimate, the nation's output of goods and services expanded at an inflation-adjusted 3.9 percent annual rate in the fourth quarter, 1.1 percentage points higher than reported in the so-called "flash" GNP estimate a month earlier. What is more, such growth was accompanied by very little inflation. The GNP price deflator—the broadest measure of inflation—was revised to a modest 2.4 percent annual rate of rise for the October-December period, compared with the 2.9 percent clip originally reported last month.

Business activity in the fourth quarter was not only strong, but also well balanced. The increase in real output was attributed to a sharp 8.3 percent annual rate increase in inflation-adjusted final sales that more than offset a reduction in business inventory spending. This was almost the reverse of the third-quarter performance when real final sales fell one percent and the seasonally adjusted 1.6 percent annual rate gain in real GNP reflected primarily a rise in inventory accumulation.

The $14.2 billion increase in inflation-adjusted business inventories in the October-December period marks a significant slowing from the $30.6 billion accumulation pace of the third quarter. As a result, excess inventories acquired during the July-September period have largely been eliminated. If inventory spending in the fourth quarter had matched the third-quarter rate, real GNP would have increased by over eight percent. On the other hand, the economy was given a boost in the fourth quarter by a sharp slowing in imports—a delayed response to the pause in business activity in the July-September quarter. This development, however, is unlikely to be repeated, now that demand is picking up again and the dollar is reaching new highs on foreign exchange markets.

GROWTH IN REAL GROSS NATIONAL PRODUCT
FIRST EIGHT QUARTERS OF RECOVERY



. . . Sets The Stage . . .

The fourth quarter GNP numbers complete the picture of the second year of the current business expansion and provide some interesting comparisons with other postwar recoveries. For one thing, despite some predictions of a subpar business recovery, inflation-adjusted GNP has grown more rapidly than in any other expansion since 1950 (see chart). This should come as no surprise since both fiscal and monetary policies in inflation-adjusted terms have been more stimulative during this recovery than they have been in any prior postwar upswing. By contrast, the inflation rate, as measured by the implicit GNP price deflator, was lower than in any business expansion since the early 1960s. Spurred by the enhanced after-tax profitability of investment that has resulted from the 1981 change in tax depreciation rules, an unprecedented capital spending boom has also accompanied this expansion. Real fixed business investment rose more than 33 percent in the last two years, exceeding by far

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the rate of increase in investment spending at this stage of the other postwar upturns.

The vigor of this business expansion resulted in impressive gains in corporate operating profits. These profits, which exclude transitory inventory profits and are not distorted by either excessive or inadequate depreciation charges, are believed to be a more reliable gauge of corporate profitability than book profits. The rapid rate of rise in operating profits in this expansion has pushed them to an all-time high, while book profits are still below the peak reached in 1980.

However, some sectors of the economy remain bleak. The rate of rise in home construction has fallen short of that experienced in previous expansions. In the first two years of recovery from the 1973-75 recession, for example, housing starts more than doubled. Now, however, despite the robust economy, housing starts are only 15 percent above the level posted at the 1982 business trough—undoubtedly a reflection of still lofty mortgage interest rates and soaring new home prices.

Finally, the foreign trade sector has yet to share in the recovery. Because the dollar has surged in value compared with most other key currencies, the strong U.S. expansion has brought an unprecedented flood of imports, while slowing exports. Imports, which after adjustment for inflation have equaled about five percent of the real GNP on average, have

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 1/23/85	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	164.757	– 5.294	+ 4.800
Loans to Depository Inst.	.784	– .416	+ .280
Float	1.624	+ .960	+ .219
Total Reserve Bank Credit	179.280	– 4.472	+ 8.546
Treasury Deposits with Federal Reserve Banks	3.300	– .163	– 1.952
Currency in Circulation	178.695	– 1.894	+11.296
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	116.635	– 1.547	+ 4.516
	1/16/85		
Member Bank Reserves:			
Total Reserves Held	41.421	+ .167	+ 2.277
Excess (Deficiency)	.714	– .515	+ .139
Net Free Reserves	.401	+ .207	+ .627
		% Change Since Three Months Ago*	% Change Since Year Ago
Monetary Aggregates†			
M1 (1/14/85)	556.8	+ 8.2‡	+ 5.7‡
M2 (December '84)	2,376.1	+ 12.2	+ 8.2
M3 (December '84)	2,988.2	+ 13.4	+ 10.2
Domestic Nonfinancial Debt (3rd Q'84)	5,760.0	+ 11.7	+ 12.9

†Seasonally adjusted.

*Seasonally adjusted annual rate.
‡Four-week moving average.

New York Money Market

Offering Rates 1/25/85	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	7.55%	7.85%	8.15%
* Federal Agencies	7.85	8.00	9.00
* Project Notes—Taxfree (46% Taxable Equivalent)	7.87	8.15	8.52
Negotiable Time CDs Manufacturers Hanover		Rates By Arrangement	
* Secondary Market—Prime	8.07	8.35	9.00

‡Finance Company Paper—Prime

5- 14 days	7.90%
15- 29 days	7.90
30- 59 days	7.90
60- 89 days	7.90
90-179 days	7.93
180-239 days	7.95
240-270 days	8.15

‡* Bankers' Acceptances

Feb.	7.95%
Mar.	7.95
Apr.	8.00
May	8.05
Jun.	8.10
Jul.	8.10

‡Industrial Paper—Prime

30- 89 days	7.88%
90-120 days	7.88

†Federal Funds Effective Rate 8.31%

‡Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	4th Q'84n	$ 3,753	$ 3,695	$ 3,432
Gross National Product (1972 Dollars)*	4th Q'84n	$ 1,661	$ 1,645	$ 1,573
Percent Change, Annual Rate	4th Q'84n	3.9	1.6	5.9
Change in Consumer Prices*	Dec '84n	2.4%	2.4%	2.4%
Change in Producer Prices*	Dec '84	1.2%	6.0%	2.4%
Civilian Employment (Thousands of Persons)†	Dec '84	106,273	105,932	103,029
Unemployment as % of Civilian Labor Force†	Dec '84	7.2%	7.1%	8.2%
Personal Income*	Dec '84	$ 3,118	$ 3,102	$ 2,860
Leading Indicators Composite Index (1967=100)†	Nov '84	166.6	164.5	162.5
Industrial Production Index (1967=100) †	Dec '84	166.2	165.2	156.2
Net Change in Consumer Installment Credit †	Nov '84	$ 7.95	$ 6.28	$ 4.82
U.S. Merchandise Trade Balance †	Nov '84	–$ 9.94	–$ 9.18	–$ 7.12
Plant and Equipment Expenditures*	1st Q'85	$337.85(a)	$321.40(a)	$293.15
Private Housing Starts (Thousands of Units)*	Dec '84	1,587	1,554	1,694
New Construction Expenditures*	Nov '84	$ 322.2	$ 318.8	$ 267.0
Total Business Inventories †	Nov '84	$ 564.2	$ 563.8	$ 511.5
Total Business Sales †	Nov '84	$ 415.0	$ 410.6	$ 386.6

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

doubled their share in the current upturn; add to this the diminished price competitiveness of U.S. produced goods in world markets due to the strong dollar and it is hardly surprising that the U.S. ran a record merchandise trade deficit in 1984.

. . . For Continuing Growth In 1985

Recent statistics seem to indicate that the economy has entered 1985 with strong momentum and that the strength is becoming more broadly based. The fundamentals for further consumer spending increases remain sound. Employment and incomes continue to grow. Lower interest rates and readily available credit should spur consumer spending for such big-ticket items as housing and durable goods. Nor does a sharp retrenchment of business spending seem likely. Fierce competition from imports continues to give the business sector a strong incentive to keep investing in cost-cutting plant and equipment. Production cutbacks in the September-October period substantially improved the inventory situation: Factory inventories fell in November, while retail inventories increased only slightly. Slower inventory growth combined with faster sales reduced the business inventory-to-sales ratio to 1.36—the first drop since May. With restored control over inventories achieved in the fourth quarter, restocking should contribute to growth in the coming months. Add to that the fiscal-monetary policy mix now in place, and it appears a good bet that the business expansion will continue throughout most—if not all—of 1985.

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Time Deposits of $100,000 or more Weekly Reporting Banks			
Nationwide (1/9/85)	159,796	– 773	+12,147
New York City (1/16/85)	34,672	– 336	+ 5,430
Commercial Paper (1/16/85)	239,657	+ 3,664	+54,766

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (1/9/85)	250,621	– 2,802	+ 27,033
New York City (1/16/85)	62,864	+ 503	+ 4,813

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (1/9/85)	657,338	– 7,027	+ 77,312
New York City (1/16/85)	144,053	+ 155	+ 15,111

Financial Markets

	Friday 1/25/85	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	7.85%	– .10	– 1.40
180-Day Bills†	8.30	– .05	– 1.30
Longest Bills†	8.85	– .10	– .98
Recent Issues:			
9³/₄s 1/31/87 (When Issued)	9.75	NA	
10⅝s 12/31/88	10.40	– .25	
11⅝s 11/15/94	11.05	– .33	
11¾s 11/15/14	11.15	– .35	
Municipals:			
Bond Buyer–20 Bond Index* (1/24/85)	9.21%	– .30	– .38
Blue List Total ($ Million)	$1,138	– $116	– $138
30-Day Visible Supply ($ Million)	$1,800	+ $341	+ $483
Total	$2,938	+ $225	+ $345
Corporates:			
Moody's Aa Composite (1/24/85)	12.28%	– .24	– .41
30-Day Visible Supply ($ Million)	$ 370	– $150	– $564
Stocks:			
Dow-Jones Averages:			
Industrials	1,276.06	+ 48.70	+ 46.06
Transportation	606.73	+ 29.01	+ 39.58
Utilities	148.18	+ .61	+ 15.52
65 Stocks	515.66	+ 18.51	+ 26.93
Standard and Poor's 500 Stocks	177.35	+ 6.03	+ 13.41
N.Y.S.E. Composite Index	102.42	+ 3.38	+ 7.66
N.Y.S.E. Avg. Daily Vol. for Week (000's)	150,038	+23,162	+ 47,320

* 46% Taxable equivalent 17.06%.

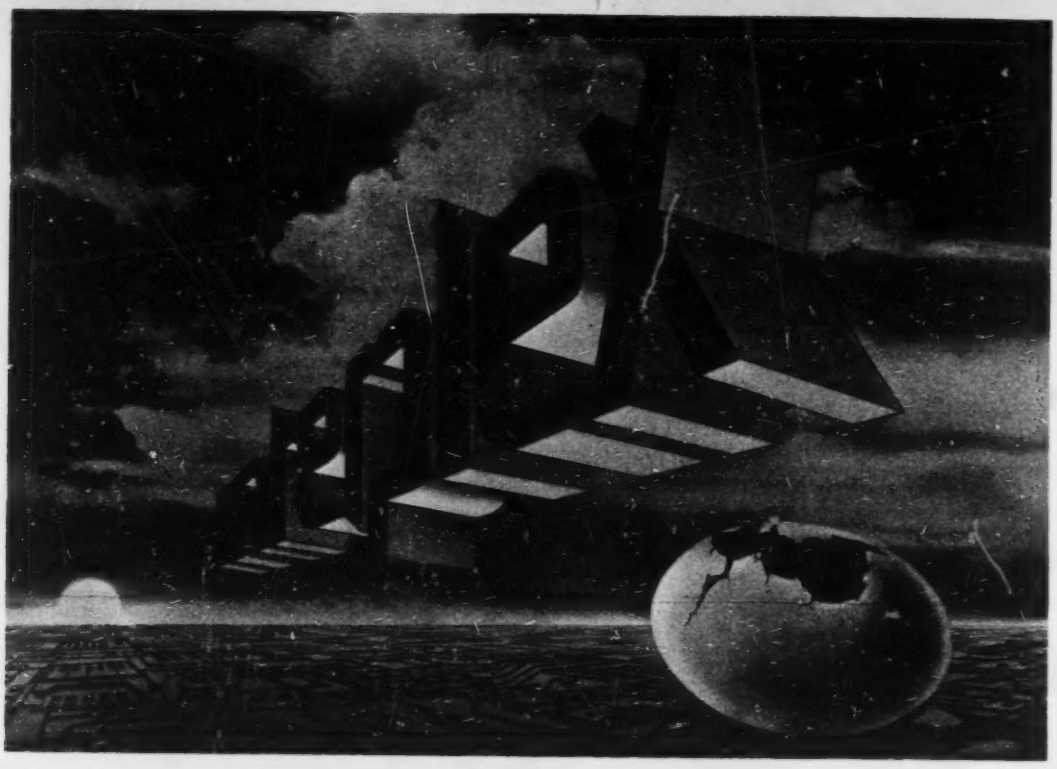
† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 1/25/85	Week Ago
Overnight	8.19%	8.00%
1 month	8.13	8.13
3 month	8.19	8.25
6 month	8.50	8.63
1 year	9.13	9.50
EURODOLLAR BONDS		
Average Yield		
Medium Term (5 to 7 yrs.)	11.05%	11.35%
Long Term (7 to 15 yrs.)	11.30	11.60

FOREIGN EXCHANGE SPOT RATES

New York Opening (1/25/85)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.01583	63.19
Canada	.7552	1.3242
Denmark	.08859	11.2880
France	.1035	9.6625
Germany	.3166	3.1590
Italy	.0005135	1947.50
Japan	.003942	253.70
Mexico	.004464	224.00
Netherlands	.2790	3.5723
Switzerland	.3765	2.6563
U.K.	1.1195	.8933



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